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IPO Report

28th Oct' 22

Snapshot

DCX Systems Ltd is among the leading Indian players for the manufacture of electronic sub-systems and cable harnesses in terms of manufacturing capability and revenue in Fiscal 2022 in the defence and aerospace sector. Company is primarily engaged in system integration and manufacturing a comprehensive array of cables and wire harness assemblies and are also involved in kitting. Company commenced operations in 2011 and have been a preferred Indian Offset Partner ("IOP") for foreign original equipment manufacturers ("OEMs") for executing aerospace and defence manufacturing projects

VALUATION

Company is bringing the issue at price band of Rs 197-207 per share at p/e multiple of 31x on FY22 basis.

Company being among the preferred Indian Offset Players for the defence and aerospace industry with global accreditations has technology enabled and scalable end-to-end capabilities. Company's business model with visibility of cash flows and ability to mitigate operational and technology risk is strategically located in Special Aerospace Economic Zone with an advanced and modern manufacturing facility. Company is well-positioned to capitalize on industry tailwinds has track record of consistent financial performance along with experienced and qualified Promoters.

Hence, we recommend "Subscribe" on issue.

Price Band (Rs./Share)	197-207
Opening date of the issue	31st Oct '2022
Closing Date of the issue	02nd Nov'2022
No of shares pre issue	77,400,000 Eq Shares
Issue Size	Rs 500 Cr
Fresh Issue	Rs 400 Cr
Offer For Sale	Rs 100 Cr
Face Value (Rs/ share)	Rs 2/share
Bid Lot	72

BIDDING DETAILS

QIBs (Including Anchor)	75% of the offer (Approx 18115942 Eq Shares)
Non-Institutional	15% of the offer (Approx 3623188 Eq Shares)
Retail	10 % of the offer (Approx 2415458 Eq Shares)
Lead managers	Edelweiss Financial, Saffron Capital
Registrar to the issue	Link Intime India Pvt Ltd.

WHAT WE LIKE

Track record of consistent financial performance

Company's revenue from operations grew at a CAGR of 56.64% between Fiscal 2020 and Fiscal 2022. Company have witnessed consistent improvement in its balance sheet position in the last three Fiscals and in the three months ended June 30, 2021 and June 30, 2022. Company's total assets have grown from ₹ 6,988.47 million, as of March 31, 2020 to ₹ 9,426.15 million, as of March 31, 2022, respectively and was ₹ 7,634.12 million, as of June 30, 2021 and ₹ 10,116.05 million, as of June 30, 2022.

Strong Clientele

Company is one of the largest Indian Offset Partner ("IOP") for ELTA Systems Limited and Israel Aerospace Industries Limited, System Missiles and Space Division (together, the "IAI Group"), Israel, for the Indian defence market for manufacture of electronic sub-systems and cable and wire harness assemblies. Over the years, company have expanded company's manufacturing capabilities and grown its order book. Company's order book has increased from ₹ 19,413.11 million, as of March 31, 2020 to ₹ 23,690.04 million, as of March 31, 2022. As of June 30, 2022, company's order book was ₹ 25,636.34 million to be executed in the Fiscal 2023 to Fiscal 2025.

Business model with visibility of cash flows and ability to mitigate operational and technology risk

Company's product portfolio backed by its system integration and manufacturing capabilities has led to company's order book growing from 45 orders aggregating ₹ 19,413.11 million, as of March 31, 2020 to 48 orders aggregating ₹ 23,690.04 million, as of March 31, 2022. As of June 30, 2022, company's order book comprised 42 orders and was ₹ 25,636.34 million with orders from several customers for projects to be executed in Fiscal 2023 to Fiscal 2025



COMPANY BACKGROUND

Company classify its operations under the following business verticals:

System Integration: Company undertake system integration in areas of radar systems, sensors, electronic warfare, missiles, and communication systems. Company provide product assembly and system integration services of various complexities to address customers' requirements. System integration services are part of a comprehensive array of electronics and electro-mechanical assembly and enclosure assembly. Company also provide product repair support for the parts that it manufacture.

Cable and Wire Harness Assemblies: Company manufacture a comprehensive array of cables and wire harnesses assemblies such as radio frequency cables, co-axial, mixed signal, power, and data cables for a variety of uses including communication systems, sensors, surveillance systems, missile systems, military armored vehicles, and other electronic warfare systems for the aerospace and defence industries as per its customers' requirements.

Kitting: Company supply assembly ready kits of electronic and electro-mechanical parts and undertake all aspects of procurement including sourcing components from suppliers approved by its customer along with a 'Certificate of Compliance' for traceability, controlled storage of moisture sensitive devices to ensure that customers receive complete, assembly-ready kits when required when they are needed for production. In addition, company also undertake certain job work services that includes assembly and testing of materials that have been supplied directly by its customers.

The table below shows company's revenue from operations for the periods indicated as per its business verticals:

	Fiscal						Three months ended June 30			
	2020		2021		2022		2021		2022	
	(Standalone)		(Consolidated)		(Standalone)		(Consolidated)		(Consolidated)	
	Amount (Rs Mn)	% of Rev from operations	Amount (Rs Mn)	% of Rev from operations	Amount (Rs Mn)	% of Rev from operations	Amount (Rs Mn)	% of Rev from operations	Amount (Rs Mn)	% of Rev from operations
System Integration	3717.65	82.75%	6160.67	96.09%	9398.65	85.27%	1081.05	87.95%	2055.02	96.36%
Cable & Wire Harness Assemblies	333.14	7.42%	195.84	3.05%	298.14	2.70%	42.87	3.49%	69.16	3.24%
Kitting	441.83	9.83%	55.12	0.86%	1325.94	12.03%	105.22	8.56%	8.36	0.40%
Total	4492.62	100.00%	6411.63	100.00%	11022.73	100.00%	1229.14	100.00%	2132.54	100.00%

Company operate through its manufacturing facility located at the Hi-Tech Defence and Aerospace Park SEZ in Bengaluru, Karnataka. Company's facility is spread over an area of 30,000 square feet and is set up for complete in-house environmental and electrical testing and wire processing.

Company's customers include domestic and international OEMs, and private companies and public sector undertakings in India across different sectors, ranging from defence and aerospace to space ventures and railways.

Company is also one of the largest Indian Offset Partner ("IOP") for ELTA Systems Limited and Israel Aerospace Industries Limited, System Missiles and Space Division (together, the "IAI Group"), Israel, for the Indian defence market for manufacture of electronic sub-systems and cable and wire harness assemblies.



INVESTMENT RATIONALE

<p><i>Among the preferred Indian Offset Partners for the defence and aerospace industry with global accreditations</i></p>	<p>DCX Systems is a preferred IOP for foreign OEMs for executing defence manufacturing projects. Company undertake “build-to-print” system integration and manufacture cable and wire harness assemblies for both domestic and international OEMs. Company is also one of the largest IOP for the IAI Group, Israel, for the Indian defence market for manufacture of electronic sub-systems and cable and wire harness assemblies. Company hold a number of key certifications that include AS-9100:2016 certification for quality management systems for aviation, space and defense products manufacturing and company’s Defence Industrial License from the Ministry of Commerce and Industry, Government of India for the manufacture of defence subsystems that includes microwave components, modules for radar and electronic warfare subsystems, microwave submodules, for command and guidance units for missile subsystems only</p>
<p><i>Strategically located in aerospace Special Economic Zone with an advanced and modern manufacturing facility</i></p>	<p>In 2020, company commissioned its new manufacturing facility at the Hi-Tech Defence and Aerospace Park SEZ in Bengaluru, Karnataka. Company’s facility is spread over an area of 30,000 square feet and is located in the same city as its key domestic customers which ensures shorter delivery times. The facility is secured by digital security cameras coupled with alarm systems with restricted access control for individual manufacturing divisions. Company’s facility is situated within a SEZ that offers duty free imports, exemption from GST and supplies that are zero rated under extant regulations. Being situated in an SEZ ensures that company is also not subject to levies imposed by the state government and its operations are eligible for single-window clearance by the relevant authority. Company’s facility is equipped with advanced machinery and equipment including laser wire maker, automatic wire cutting and stripping machine, coaxial stripping machine, crimp tools, controlled torque tools, vacuum pump and desiccator, tinned welding machine and temperature controlled soldering station. Company’s facility is set up for complete in-house environmental and electrical testing and contains the latest inspection and testing equipment. Company’s manufacturing line and equipment meets the standards prescribed by the Institute for Printed Circuit (“IPC”). Company manage its operations through an enterprise resource planning system.</p>
<p><i>Well-positioned to capitalize on industry tailwind</i></p>	<p>There is a strong focus and various initiatives by the Government of India in the aerospace and defence sectors and in particular for private players including micro, small and medium enterprises. India’s defence budget outlay for Fiscal 2023 is ₹ 5,250 billion, the annual budget representing a 10% increase over the budget of ₹ 4,780 billion in Fiscal 2022. The Indian Defence private sector has witnessed a substantial growth owing to the implementation of government reforms. In Fiscal 2022, 2021 and Fiscal 2020, private players in the Indian defence sector accounted for 70%, 86% and 88%, respectively, of the exports generated. Private players like company plays an important role in meeting the offset obligations and helping the goals set by the Government of India with reference to be a US\$ 5 Billion export country by 2025.</p>
<p><i>Experienced and qualified Promoters and senior management team supported by a committed employee base</i></p>	<p>Company possess a qualified senior management team with considerable industry experience. Company’s Promoter, Chairman and Managing Director, Dr. H.S. Raghavendra Rao, is an industry veteran with over two decades of experience in electronic manufacturing and in the defence and aerospace sectors. Its Non-Independent and Non-executive Director, Neal Jeremy Castleman, has been involved in the electronics industry since 1997 and possesses extensive electronics manufacturing experience.</p>



OBJECTS OF OFFER

Company proposes to utilise the Net Proceeds of the Fresh Issue towards funding the following objects:

1. Repayment/ prepayment, in full or part, of certain borrowings availed of by company;
2. Funding working capital requirements of company;
3. Investment in company's wholly owned Subsidiary, Raneal Advanced Systems Private Limited, to fund its capital expenditure expenses; and
4. General corporate purposes .

RISKS

Company's top three customers accounted for 73.26%, 86.90%, 80.55%, 85.70% and 96.83% of its revenue from operations in Fiscal 2020, 2021 and 2022 and in the three months ended June 30, 2021 and June 30, 2022, respectively. The loss of one or more such customers or a reduction in their demand for its products could adversely affect company's business, results of operations, financial condition and cash flows.

Source:RHP

INDUSTRY OVERVIEW

Defence Exports of India

Due to the relaxation of export limitations and policy changes, Indian defence exports are expected to rise rapidly. This is supported by the expanding capabilities of Indian defence suppliers. In comparison to defence public sector entities, the private sector now dominates Indian defence exports, which is expected to drive income prospects. Organizations such as DCX are well positioned to capture the growth in Aerospace and Defence exports. In a report published by India Brand Equity Foundation ("IBEF") in November 2021, the GOI has set a target for US\$ 25.00 billion for defence production by 2025. It includes US\$ 5 billion in exports. In the next five years, India aims to export military hardware products worth US\$ 5 billion. Additionally, the value of India's defence exports in Fiscal 2020 was US\$ 1,231.9 million and this moderated to US\$ 771.8 million in Fiscal 2021. A dip in the exports for the year 2020-2021 is largely attributed to manufacturing disruptions and supply chain which have eased now.

Indigenous Industry Drivers

The Indian Aerospace and Defence segment is expected to account to around USD 70 billion by the year 2030. The overall growth of this market is steered by the increased investment in modern infrastructure and government's efforts to drive indigenous development of aerospace and defence products. Between 2016-2020, the defence manufacturing sector grew at a CAGR of 3.9%. India's defence manufacturing sector recorded increased production to US\$ 11.85 billion in Fiscal 2022 from US\$ 10.9 billion in Fiscal 2021. Government's present objective is to enhance the value of defence production to USD 25 billion by 2025. An additional exports target of USD 5 billion has also been set by the GOI. In Fiscal 2020-2021, it was noted that the defence exports moderated by 60% to USD 771.76 million from USD 1231.89 million (Fiscal 2019-2020), this was due to pandemic related delays. The Indian Defence private sector has also witnessed a substantial growth owing to the instating of government reforms. In Fiscal 2021-2022, 2020-2021 and Fiscal 2019-2020, it was noted that the private players in the Indian defence sector accounted for 70%, 86% and 88% of the exports generated respectively. The private sector's exports stood at ₹ 72.71 billion in Fiscal 2020-2021 and ₹ 80.07 billion in Fiscal 2019-2020. India's defence exports for 2021-2022 were estimated at US\$1.63 billion. The private sector accounted for 70% of the exports, while public sector firms accounted for the rest with the share of public sector going up from previous years. Policy changes that reduce program delays and accelerate acquisition are poised to be instated into the Indian Defence environment. The industry is on the cusp of change owing to MoD's objective of doubling defence production by the year 2025. In the same period, the MoD also aims at increasing the defence exports by 5 folds through increased involvement of private players as well as the privatisation of Ordnance Factory Board.


Consolidated Financials

(Rs in Mn)

Financials	FY20	FY21	FY22	Q1FY23
Total Revenue (A)	4492.62	6411.63	11022.73	2132.54
Total Expenditure (B)	4430.45	6310.83	10352.82	2083.48
EBIDTA	62.17	100.80	669.91	49.06
EBIDTA Margin	1.38	1.57	6.08	2.30
Other Income	159.67	420.79	220.61	70.00
Depreciation	13.76	24.31	21.75	4.59
EBIT	208.08	497.28	868.77	114.47
Interest	79.41	99.22	113.22	49.76
PBT	128.67	398.06	755.55	64.71
Extraordinary item	0.00	0.00	0.00	0.00
PBT	128.67	398.06	755.55	64.71
Tax	31.23	102.48	99.47	9.03
PAT	97.44	295.58	656.08	55.68
NPM	2.17	4.61	5.95	2.61
ROE %	56.75	63.18	55.79	4.52
EPS	5.57	16.89	8.48	0.72
Eq Cap	35.00	35.00	154.80	154.80
Net Worth	171.70	467.86	1,175.90	1,231.84

(Source: RHP)

Peer Comparison

Company Name	Total Income (Rs in million)	P/E	EPS	RONW %	NAV as at March'2022
Astra Microwave	7568.41	73.15	4.37	6.5	67.61
Bharat Electronics	155997.20	32.36	3.28	19.5	16.83
Centum Electronics	7879.64	--	-23.70	-26.9	154.07
Data Patterns	3148.10	61.56	19.48	16.4	110.72
Paras Defence & Space	1855.34	84.69	7.78	7.2	97.06
DCX Systems	11243.34		9.19	55.8	15.19

(Source: RHP)



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